

INFORMATION PAPER

SUBJECT: Severance Pay Tax Refund

1. Purpose. To inform disabled soldiers, separated with severance pay, of possible tax benefits.
2. Under the current department of Defense Finance and Accounting Service (DFAS) and the Internal Revenue Service (IRS) interpretations of federal law, there are tax advantages you should know about. If your disability falls under one of four categories you are eligible for these benefits. The first three are based on administrative determinations referred to as 10 a, b, or c, on DA Form 199, and are made by the Physical Evaluation Board (PEB). The fourth is a disability determination made by Veterans Affairs (VA). You should ask your Physical Evaluation Board Liaison Officer (PEBLO) if your disability was designated as either 10a, b, or c in the PEB proceedings. If such a designation was granted, follow the directions in section I. If you did not receive this designation, skip to section II. (If you are unable to follow the below instructions, you should consult with a legal assistance attorney or seek free tax assistance from an organization such as Volunteer Income Tax Assistance (VITA).)
3. **SECTION I.** a. Since your disability was designated 10 a, b, or c, your entire severance pay is tax free, but the DFAS computer has not been programmed to stop taxes from being taken out. In order to get a refund of these taxes you must submit to DFAS copies of your DD 214, separation orders, and the attached sample cover letter #1. Due to DFAS operating procedures your request cannot be processed until twenty (20) days after you have effectively separated. Consequently, if you submit your request any earlier it may not get processed at all. After the (20) days have elapsed, fax your request to 317-510-7915 or mail it to:

THE DEFENSE FINANCE AND ACCOUNTING SERVICE
INDIANAPOLIS CENTER
ATTN: DFAS IN FJEC
8899 EAST 56TH STREET
INDIANAPOLIS, IN 46249-0801

- b. If you do not receive a refund of all your taxes within two (2) months of your request contact Separation and Reenlistment Division at DSN 699-7731/7027/6129/6142 or commercial 317-510-7731/7027/6129/6142, fax 317-510-7915.
- c. The request, with all necessary documentation, must be received by DFAS by 31 December of the year in which you received your severance pay check. If your request does not meet this deadline, DFAS can only provide you with a corrected IRS Form W-2. To obtain a corrected IRS Form W-2, you must contact DFAS at Separation and Reenlistment Division, DSN 699-7731/7027/6129/6142 or commercial 317-510-7731/7027/6129/6142, fax 317-510-7915. This form helps to demonstrate to the IRS that you overpaid your taxes in the year that you received your severance pay. You can use the corrected Form W-2 to file your tax return that year and get

a refund or, if your tax returns have already been finalized, you will need to petition the IRS for a refund.

d. To secure a refund from the IRS you must do the following: Mail to the IRS copies of your individual tax return for the year in which you received your severance pay, original W-2 provided by DFAS, corrected W-2 provided by DFAS, DD 214, separation orders, and the enclosed sample cover letter #2.

e. Address your request and sample cover letter to your servicing IRS location.

4. **SECTION II.** a. If your PEBLO tells you that the PEB found you ineligible for a 10 a, b, or c designation, your severance pay will be taxed INITIALLY. However, you still qualify for a tax break if you are awarded a VA disability rating for the same condition that resulted in your medical discharge. For example, if you are found unfit by the PEB for a right knee injury, and, subsequently, the VA also rates that same right knee, you can apply for a refund of the taxes withheld. To secure your refund, upon receipt of your VA rating, follow the directions below.

b. The Defense Finance and Accounting Service (DFAS) can refund all of your severance pay taxes. **However, as of the date of this paper, the IRS has not officially endorsed the DFAS position that you are eligible for a full refund. Specifically, the IRS has not officially stated how much of a refund you are eligible to receive. Consequently, in the future the IRS could claim that you underpaid your taxes for the tax year in which you received your refund from DFAS.**

(1) To secure the refund you must send copies of your separation orders, DD Form 214, VA award documentation, and the attached sample cover letter #3 by fax 317-510-7915 or mail to:

THE DEFENSE FINANCE AND ACCOUNTING SERVICE
INDIANAPOLIS CENTER
ATTN: DFAS IN FJEC
8899 EAST 56TH STREET
INDIANAPOLIS, IN 46249-0801

(2) If you follow the above guidelines but are not provided a refund within two (2) months of your request, contact the Separation and Reenlistment Division at DSN 699-7731/7027/6129/6142 or commercial 317-510-7731/7027/6129/6142, fax 317-510-7915.

(3) The request, with all necessary documentation, must be received at DFAS by 31 December of the year in which you received your separation paycheck. If your request does not meet this deadline, DFAS can only provide you with a corrected IRS Form W-2 (There can be no corrected W-2 if the VA rating is not awarded in the same calendar year as the issuance of the severance pay). To obtain a corrected IRS Form W-2, you must contact DFAS at Separation and Reenlistment Division, DSN 699-7731/7027/6129/6142 or commercial 317-510-7731/7027/6129/6142, fax 317-510-7915. This form helps to demonstrate to the IRS that you

overpaid your taxes in the year that you received your severance pay. You will then need to petition the IRS for a refund.

(4) If your military pay records reflect that you still owe money to the U.S. Government your account may have been transferred from the Indianapolis Finance Center. If this is the case you must contact DFAS-DE/FYDEC at 303-676-4628 or 1-800-962-0648 to arrange for a corrected W-2.

(5) If you are not eligible to request a refund from DFAS, and you have not filed your tax return for that tax year, you may file a tax return and include a copy of the VA Award to inform the IRS that the severance pay should not be considered taxable. If you have already filed your tax return for that tax year you will have to ask the IRS for a refund. **Be aware that, as of the date of this paper, the IRS does not have an official position on what portion of your severance pay is tax-free. Consequently, you may not get a full refund. Moreover, in the future the IRS could claim that you underpaid your taxes for the tax year in which you received your refund.** In an attempt to secure a refund from IRS, you must mail to the IRS copies of your Individual Tax Return (or amended return, if appropriate) for the year in which you received your severance pay, original IRS Form W-2, corrected IRS Form W-2 provided by DFAS, VA disability award documentation, DD Form 214, separation orders, and the enclosed sample cover letter #4.

(6) Address your request and sample cover letter to your servicing IRS location.

Enclosures
4 Sample letters

Info paper last updated 25 May 00

SAMPLE COVER LETTER #1

DEFENSE FINANCE AND ACCOUNTING SERVICE
INDIANAPOLIS CENTER
ATTN: DFAS IN FJEC
8899 EAST 56TH STREET
INDIANAPOLIS, IN 46249-0801

____/____/____

Dear Sir/Ma'am:

I was medically discharged from the U.S. Army/ARNG, on _____. I was awarded severance pay in the amount of _____ dollars. My disability was categorized as tax free under 26 U.S.C. § 104(b)(2), but DFAS withheld twenty-eight percent (28%) taxes.

I am submitting the following documentation to demonstrate that I am eligible for a refund of all taxes withheld.

- Separation orders
- DD Form 214

Please contact me if you require additional information. My current phone # is (____) ____-____. My current address is _____
_____:

Your prompt attention to this request is appreciated.

Sincerely,

SAMPLE COVER LETTER #2

INTERNAL REVENUE SERVICE CENTER

____/____/____

Dear Sir/Ma'am:

I was medically discharged from the U.S. Army/ARNG, on _____. I was awarded severance pay in the amount of _____ dollars. My disability was categorized as tax free under 26 U.S.C. § 104(b)(2), but the Army withheld twenty-eight percent (28%) taxes.

I am submitting the following documentation to demonstrate that I am eligible for a refund of all taxes withheld.

- Individual Federal Tax Return for the year _____ (the year in which I received my severance pay)
- Original IRS Form W-2
- Corrected IRS Form W-2
- Separation orders
- DD Form 214

Please contact me if you require additional information. My current phone # is (____) ____-____. My current address is _____
_____.

Your prompt attention to this request is appreciated.

Sincerely,

SAMPLE COVER LETTER #3

DEFENSE FINANCE AND ACCOUNTING SERVICE
INDIANAPOLIS CENTER
ATTN: DFAS IN FJEC
8899 EAST 56TH STREET
INDIANAPOLIS, IN 46249-0801

____/____/____

Dear Sir/Ma'am:

I was medically discharged from the U.S. Army/ARNG, on _____. I was awarded severance pay in the amount of _____ dollars. My disability severance pay was taxed at twenty-eight percent (28%). This money was withheld for payment to the IRS.

I have now received a disability rating from the Veterans Affairs (VA) for the same disability for which the Army compensated me, and in the same calendar year that I received my severance pay. Therefore, under the provisions of 26 U.S.C. § 104(b)(2), I am eligible for DFAS refund of the taxes withheld.

Enclosed are copies of the following documents to support my request:

- VA award documentation
- Separation orders
- DD Form 214

Please contact me if you require additional information. My current phone # is (____) ____-____. My current address is _____
_____.

Your prompt attention to this request is appreciated.

Sincerely,

SAMPLE COVER LETTER #4

INTERNAL REVENUE SERVICE CENTER

____/____/____

Dear Sir/Ma'am:

I was medically discharged from the U.S. Army/ARNG, on _____. I was awarded severance pay in the amount of _____ dollars. My disability severance pay was taxed at twenty-eight percent (28%). This money was withheld and paid to the IRS in tax year _____.

I have now received a disability rating from the Veterans Affairs (VA) for the same disability for which the Army compensated me.

Under the provisions of 26 U.S.C. § 104(a)(4), and 26 U.S.C. § 104(b)(2) (D), as interpreted by the District Court in St. Clair v. United States, disability severance payments are amounts received for personal injury(ies) and are thus excludable from taxable income. The only caveats are (1) a VA rating for the injury for which severance pay was granted and (2) a waiver of an equivalent amount of VA disability pay (See IRS "Action on Decision", #cc-1992-006, distributed 19 Dec 1991).

As indicated, I am in receipt of a VA rating for the injury for which I was granted severance pay, and I have waived a like amount of my VA disability pay. Therefore, I request a refund of taxes withheld in year _____, the year in which I received my severance pay.

Enclosed are copies of the following documents to support my request.

- Individual Federal Tax Return for the year _____ (the year in which I received my severance pay)
- Original IRS Form W-2
- Corrected IRS Form W-2
- VA award documentation
- Separation orders
- DD Form 214

Please contact me if you require additional information. My current phone # is (____) ____-____. My current address is _____.

Your prompt attention to this request is appreciated.

Sincerely,